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Editorial Comment

Budgets, Past and Present

With the exceptional instance of an end of the year budget out of the way, and with the exigencies of the war over, this year 1946 presents a splendid opportunity for simplification in the methods and timing of tax changes. Probably there are too many intricate considerations to allow any alteration in the general practice of parliament and the provincial legislatures meeting during the early months of the year. This means that proposed legislation will continue to be under discussion at that time, and that new law will go on the statute books usually before midsummer. It is in workable accord with the fiscal years of the governments, which for the most part end on March 31st, thus enabling the governments and the members to deal with preliminary accounts for the year just ended, and with estimates for the year just beginning. But since this convenient arrangement was developed, we have experienced the introduction of a big new factor—the calendar year as the period for assessment of income tax and some other new levies. The Dominion government in a few instances went to the extreme of amending tax bases or rates for the calendar year which had already ended, but this may now be viewed as past history. The governments, however, are

still faced with the necessity for implementing their programs for their years commencing April or thereabouts, and this will no doubt often mean that tax changes will take effect with the calendar year then current. This is at least reasonable, and taxpayers have the added consolation that their burden is now on the decline. The other reasonable alternative of course is to give effect to the changes at a date subsequent to the legislation.

Financial Statements in New Forms

The Canadian Chartered Accountant has lent its columns to discussion of new forms of financial statement, but thus far has not taken any material part in the discussions. After all, an editor is supposed to be at least a little bit like a politician, and should find out the viewpoint of his constituents before he adopts it for his own, and on this particular subject it has been just a little difficult to ascertain whether professional accountants as a body are prepared to stick to their texts or are willing to be reformed. Even now, with the benefit of some discussion and correspondence, we merely venture the hope that, in whatever strange designs the accountant may take part, he will be a moving spirit and not a rubber stamp.

The danger to the accounting profession is that any such changes, when inspired by the public relations department or some other branch of business, may result in the accountant losing the initiative. The form and content of the financial statement, as prepared by the accountant and as reported on by the auditor, is the peculiar preserve of the accounting profession. In the face of a suggestion that the financial statement be amended in the interests of publicity, the accountant may very well take heed lest he fall.

Deductible Expenses

When The Exchequer Court decided the case of Siscoe Gold Mines v. The Minister of National Revenue, last November, it embraced in the one decision four typical kinds of business outlay, and it abandoned them all in favor of the tax collector. Since similar types of expense have been thrown out before, there appears to be nothing new in the way of legal principle, so that the only remarkable feature is the combination of four varied items in the one case.

The four kinds of claims were as follows: Legal expenses defending title to property; exploration and development work on neighbouring property; payment to a director for special services; and token rewards, in the form of gold medals, to directors and other persons.

The court ruled, as it has ruled before, that the expense of protecting title to a capital asset (in this case title to the property itself) is not an income charge; that investigation of what might become a capital asset is not an income charge; and likewise that neither compensation for special services, nor the token rewards mentioned, are "necessarily laid out or expended for the purpose of earning the income" as required by the act.

In the operation of business, the defense of property title, of trade marks, of copyright, and of other capital assets, is as much an essential outlay as is physical protection against the weather, or insurance, or provision for depletion. Yet while the tax authorities recognize maintenance, insurance premiums, and both depreciation and depletion, they refuse to admit any outlay incurred in protecting ownership. The net result of this attitude is that all capital or ownership must procure an extra profit or gain to meet the cost of protecting itself. If capital does not thus protect its own survival, then it is bound to be depleted.

Some other interesting aspects of this decision are dealt with in an article on "Expenses of Earning Income" which appears elsewhere in this issue.

Expenses of Earning Income

By B. I. England, B.Com., C.A.
Kingston, Ontario

THE purpose of the Income War Tax Act is, in simple terms, to provide for the division of net income between the taxpayer and the revenue department of the government. When all expenses of obtaining or "earning" the income have been met there may remain a net income or profit. The act is intended to see that a certain part of this residue is given to the government.

But under the legal interpretations which have been accumulating this purpose is not always carried out in full.

Before elaborating on this statement let us look at an explanation of what constitutes net earning or income less the expenses which have been laid out for the purpose of providing that income. Let us take the case of a limited company. In simple terms what happens when a company is organized for purposes of gain is that moneys are subscribed and paid up, to be used in the type of business as set out in the letters patent or charter. In order to realize profits these moneys are spent in exchange for values such as current goods or services which may have to be renewed several times a year, or for long-term or capital assets which may last a number of years. In any case the purpose of the expenditure is for the making of a net profit available to the shareholders, and incidentally to the Income Tax Division of the Department of National Revenue.

All of these expenditures are necessarily for that object. In fact besides a possible return of capital there are only two kinds of expenditure possible for such a corporation; either they are (1) for the purpose of making income available to the shareholders and the taxation authorities, or they are (2) distributions of that profit.

Under the wording of sections 6a and 6b, however, which state that expenditures to be allowed as a deduction from income for taxation purposes must be wholly, exclusively and necessarily laid out for the earning of income, and that capital expenditures are not allowed except at the rate of depreciation, depletion or obsolescence allowed by the minister, we have the following peculiar findings.

In the case of the Montreal Coke and Manufacturing Company vs. the Minister of National Revenue, financial costs incurred in securing a reduction of bond interest were disallowed as being not necessarily for the purpose of earning income as they were for the purpose of conserving income. It is apparent to everyone that it is unreasonable to decide that any part of the expenses, incurred in making net income or profit available, should apply against the shareholders' part only, as distinct from that part of profit appropriated by the government. Any clause in the act which is capable of a final decision such as that is due for revision.

Siscoe Gold Mining Case

In a more recent case, that of the Siscoe Gold Mining Company, certain heavy legal expenses in respect to the title of mining properties were stated to be unrelated to the business of gold mining. This is a curious statement as the company was certainly not engaged in farming or fishing or anything but gold mining. Such expenses must necessarily have been for the purpose of gold mining and for the purpose of earning revenue by that mining which was the only purpose of the company. Whether they were of a long or short term nature is beside the point. They were certainly spent for the purpose of the enjoyment of the use of the mining property.

In the same case the expenses of drilling on adjacent property which was under option was considered to be a capital item, even though the options were immediately abandoned upon the report of the results of these development costs. This does not seem to distinguish between what is capital or current expense. If it actually had been a capital charge the act should have allowed a determination of fact as to how long this capital charge should take to be written off out of revenue, in other words how long would the value of these now useless holes be kept on the books for income tax purposes; presumably they were subject to depletion at some rate.

In the same judgment certain expenses were disallowed on the ground that they were in connection with financing the company (see also Montreal Coke & Manufacturing Co. above). Further in the same case certain emoluments to the directors were deemed to be not necessarily for the

purposes of earning the income of the company. Emoluments to directors might well come under the regulations of the government during wartime in the same way as salaries and wages but there seems to be no justification for a decision that they had nothing to do with the earning of income.

There could be only two purposes for the payments, they were necessarily one or the other, either they were an expense for the purpose of earning net income or they were a distribution of net revenue—a dividend.

In the cases cited above certain expenses determined by managers or directors to have been advisable and which were, in one case anyway, agreed to have been wisely and economically incurred and to have materially increased the net profit or income available, have been determined by the courts to be not allowable as deductions from income for taxation purposes.

These decisions are exasperating to a person interested in fairness of the government of the country, as they must be more particularly to those who were responsible for incurring expenditures. They outrage our sense of justice. It is time sections 6a and 6b were revised or clarified.

An Observation

By W. W. Smith, C.A.
Toronto, Ontario

IN THE SECOND year of world war II, I had occasion to set down on paper certain observations with respect to how necessary it was to face squarely the daily difficulties of keeping the business ship headed in the right direction when, in those days in 1940, all thoughts dwelt on the grim reality of the advancing enemy.

Leafing through my scrap book the other day, I came across the article and found certain parts of it just as stimulating to me now as then. The article was titled "Let Us Clear the Deck" and in part said: "Restrictions, regulations, shortage of materials and labour and a backlog of work to be done somehow must be handled and can be handled if management faces the issues squarely. Internal organization, alertness to new problems, changing conditions, the ability to alter policies on short notice are essen-

tial if the business ship is to deliver the goods. It is not now so much the problem of selling goods as it is of producing them so let us clear the deck and face the issues squarely by challenging old or customary methods of doing business. Let us organize and be alert to the present and future, lay our plans soundly, and the result is bound to be success."

Now that the war has ended in the allies' favour it must have been true that business leaders did "clear the deck" and face the issues of the times. To-day we have a new and reverse set of problems, not those of production to wage war, but production to meet changing conditions as the result of war's end. Not only must the long suppressed needs of our own people be met but war devastated countries must be fed, clothed and supplied with materials to rehabilitate themselves, and our industries appear to be exceptionally well fitted to do the job. New uses of raw materials and improved methods of manufacturing, the new inventions of science, all seem to point to a new order of things and the unique part of it appears to be that the big and small, the old-established as well as the war-born enterprises will be starting from scratch together. Business will become more and more a problem of selling the goods which our industries produce. The younger and smaller organizations may have more flexibility and aggressive action than the other type. The result in the course of the next few years should be interesting.

Let us make sure that we are ready to meet the new order of things to come and to make the most of our opportunities now. Let us ask ourselves the following questions.

1. Is our internal organization as strong and aggressive as we can make it within our means?

2. Are we as alert to current problems and developments as we can be?

3. Have we studied our immediate opportunities to the fullest extent possible?

4. Are the methods and policies followed by us in the past adequate for the present and future?

5. Are we missing an opportunity to make more use of our facilities to develop new lines of manufacture within our organization?

6. Are we making every effort to prepare to market goods in the export markets of the world?

Let us give them some honest thought.

Co-operative Trends and Problems

A paper given by W. F. Chown, C.A., on December 18, 1945, at the Division Workshop Conference, Farm Credit Administration, United States Department of Agriculture.

(The report of the Royal Commission on Co-operatives, which is dealt with in the course of this address, did not become available in time for the 1945 budget amendments, so that the recommendations have not yet been given any effect.)

IN CANADA, as in the United States, co-operative business methods have been applied to the marketing of agricultural products to a much greater extent than to any other form of business activity. Consequently, when the Economics Division was formed within the Dominion Department of Agriculture in 1929, responsibility for maintenance of national records of co-operatives was transferred to it from the Department of Labour. In co-operation with provincial departments, the division assembles annual statistical records from co-operative associations and from time to time conducts special studies having to do with costs, credit, management and other matters relating to co-operative enterprise. The division stands ready to lend assistance and to answer questions as requested and has published two directories of co-operative associations in Canada. The special studies had to be discontinued during the war but the statistics have been published annually and a directory was issued this summer.

There are 2,618 associations listed in this directory. These do not include credit unions, mutual fire and hail insurance companies, mutual telephone companies or housing associations or associations organized for purely social and educational purposes. Those listed, then, are associations marketing products or buying supplies for members or performing miscellaneous services not already enumerated.

Most of the associations listed are incorporated. Incorporation is usually under a provincial co-operative act, though a few are incorporated under general companies acts and several others by special act of parliament. There is no Dominion Co-operative Act, in spite of a wide-spread desire for one.

The size and type of business varies widely. Of the associations for which the volume of business is known, 80 per cent had an annual turnover of less than $100,000 and

more than half of these, or 42 per cent of the total had annual sales of less than $25,000. On the other hand, each of 48 associations, 2.3 per cent of the total, had a volume of business in excess of $1,000,000. Included in this group of 48 are the Canadian Co-operative Wool Growers Limited, a national organization; the United Grain Growers Company Limited and the three western wheat pools; the United Farmers Co-operative Company Limited, the Coopérative Fédérée de Québec and Maritime Co-operative Services Limited, which three act as central selling agencies and wholesales for Ontario, Quebec and the Maritimes respectively; there are also four other wholesale associations.

Fourteen of the 48 are engaged almost exclusively in the marketing of live stock. Even within this group there is a variety of functions, for one operates a packing plant, three operate stockyards, two are central selling agencies and eight are livestock shipping associations. Another two of these 48 larger co-operatives are engaged in the marketing of tobacco and the control of acreage. These are bargaining associations and while the value of the tobacco sold is counted for dollar volume of business, the revenue of these co-operatives consists of tolls collected on the sale of the crop by members to licensed buyers under terms arranged between the associations and the buyers.

Annual Statistical Reports

The Economics Division has published thirteen annual reports, 1932-1944. The twelfth report, that for the crop year ending in 1943, has become quite famous and I would like to give a few figures from it together with some comparisons. In 1943 reports were received from 1,650 associations compared with 795 in 1932, the value of farm products sold was $295 million compared with $135 million in 1932, supplies bought for members had increased to $56 million from $11 million in 1932. It was estimated that in 1943, 24 per cent of the main farm products entering commercial channels of trade was handled by co-operatives. In view of this expansion, it is not surprising that the Income Tax Payers Association of Canada and various trade associations urged the government to assess the surpluses of these associations for income and excess profits taxes, nor that officials of the Income Tax Division scrutinized their legislation and examined the operations of co-operative as-

sociations to determine whether or not they were liable for tax.

Before turning to the income tax question, I should like to discuss the most recent figures, those for 1944 released in September of this year. Again increases are reported all along the line. The business of 1,792 associations is included. Sales of farm products amounted to $460 million, sales of supplies $65 million and total business $528 million. Compared with 1932, the number of associations had increased by 125 per cent and the total volume of business by 260 per cent. Part of the increase is the result of more adequate coverage and the inclusion of urban co-operatives in 1941 and part of the increase in dollar volume is the result of price increases. Nevertheless the increase has been steady and important.

From 1943 to 1944 the increase reported in total business amounted to $175 million which is nearly 50 per cent for the one year. The increase in the value of farm products marketed was $164 million of which the increase in grain and seed alone amounted to $130 million leaving an increase of $34 million in all other commodities.

The carryover of grain at July 31, 1943, had reached the highest point in our history. On September 27, 1943, the fixed initial price for No. 1 Northern wheat basis, head of the lakes, was raised from 90c to $1.25 per bushel. Deliveries to country elevators and loadings over the platform were 83 million bushels more during the crop year 1943-44 than during the previous year. On the other hand, sales increased to such an extent that the carryover was greatly reduced at the end of the year. The increase in price and the reduction in inventories accounted for much of the increase in dollar value of grain sold. It is estimated that the number of bushels delivered at co-operative facilities in 1943-44 was 46 per cent of the total in the three prairie provinces, or 2 per cent more than in the previous year.

Sales of live stock and livestock products increased by $32 million or 27 per cent over the previous year. For Canada the cash income from these products increased by only 14 per cent, indicating that a higher proportion of the total was marketed co-operatively than in the previous year.

For fruits and vegetables, honey, maple products, and tobacco, the increase reported was only $663,000 or less

than 2 per cent, whereas cash income from these crops increased by 12 per cent indicating a reduced proportion marketed through co-operative organizations. It is well known that because of price ceilings and scarcity, higher proportions of honey, maple products, berries and other fruits have been marketed directly from producer to consumer than in previous years.

Income Tax

The income tax was introduced into Canada in 1917 as a war measure and has remained with us ever since. In the original act the income of mutual corporations, not having shares, was exempt. In 1919 a ruling was made permitting patronage dividends to be considered as trade discounts deductible before arriving at taxable income. The income tax authorities held that dividends paid to shareholders as interest on capital, are profits and gains, liable to assessment as income of the corporation and this view was upheld by the courts in 1929.

Following this adverse decision, representations were made to the government asking that the entire surpluses made by co-operatives in trade relations with their members be recognized as savings and not as taxable income or profit. The Income War Tax Act was amended in 1930 by inserting in section 4, which enumerates various classes of profits that shall not be liable to taxation under the Act, paragraph (p) as follows:

> The income of farmers', dairymen's, livestockmen's, fruit growers', poultrymen's, fishermen's and other like co-operative companies and associations, whether with or without share capital, organized and operated on a co-operative basis, which organizations
>
> (a) market the products of the members or shareholders of such co-operative organizations under an obligation to pay to them the proceeds from the sales on the basis of quantity and quality, less necessary expenses and reserves;
>
> (b) purchase supplies and equipment for the use of such members under an obligation to turn such supplies and equipment over to them at cost, plus necessary expenses and reserves.
>
> Such companies and associations may market the produce of, or purchase supplies and equipment for non-members of the company or association provided the value thereof does not exceed twenty per centum of the value of the produce, supplies or equipment marketed or purchased for the members or shareholders.
>
> This exemption shall extend to companies and associations owned or controlled by such co-operative companies and associations and organized for the purpose of financing their operations.

At the time of its enactment the explanatory paragraphs printed in connection with the bill and the state-

ments of its sponsors in the House made it clear that it was intended to exempt all co-operatives of the marketing and consumer type, from liability for income tax. This was found to be quite satisfactory for a time but trouble developed from internal and external causes. The clause itself was not sufficiently explicit and the word "co-operative" was not defined. Co-operatives entered fields of processing and manufacturing that they had not been engaged in at the time this exemption was granted, methods of financing were introduced such as revolving funds, federations came into being and subsidiary companies were acquired or formed for purposes other than financing operations. Under these conditions the income tax officials had difficulty interpreting the act in a satisfactory manner. Then in 1939 war came and immediately following it higher rates of income tax and the enactment of an Excess Profits Tax Act in 1940. Co-operatives became liable for tax if they paid interest on capital, if they processed their products beyond a bare minimum, if they set aside reserves other than for bad debts and depreciation, if they united into federations or if they acquired subsidiaries, and it was alleged that different interpretations were given by different district inspectors. The wheat pools were assessed for tax and gave notice of appeal. Outside groups were pressing the government to take action.

The Co-operative Union of Canada urged the government to clarify its legislation and following various representations over an extended period a delegation from the union met the Minister of Finance in July 1944. After considerable discussion proposals were made to the delegates which they felt unable to accept being bound by their original instructions. Meetings were again held early in September with no decision reached.

Later in that month the three wheat pools announced a reduction in their handling charges for grains amounting to 2c per bushel in the case of street grain, and 1c per bushel on consigned grain. The privately-owned line elevator companies protested this, vigorously claiming such a cut would ruin them.

Finally on November 16, 1944, a harassed government took the way out open to governments in the British Commonwealth—I expect your government has a similar means

of escape—and appointed a Royal Commission to investigate and report.

The terms of reference set out in P.C. 8725 are as follows:

> The Commission is authorized "to enquire into":
>
> (a) the present position of co-operatives in the matter of the application thereto of the Income War Tax Act and The Excess Profits Tax Act, 1940, and
>
> (b) the organization and business methods and operations of the said co-operatives as well as any other matters relevant to the question of the application of income and profits tax measures thereto, and
>
> (c) the comparative position in relation to taxation under the said acts of persons engaged in any line of business in direct competition with co-operatives,
>
> and directed to
>
> report, in so far as the same can conveniently be done, all facts which appear to them to be pertinent for determining what would, in the public interest, constitute a just, fair and equitable basis for the application of the Income War Tax Act and The Excess Profits Tax Act, 1940, to co-operatives and to persons other than co-operatives in respect of methods of doing business analogous to co-operative methods, such as the making of payments commonly called patronage dividends and to make such recommendations for the amendment of existing laws as they consider to be justified in the public interest;

Beginning on January 15, 1945, in Vancouver, the commission conducted enquiries in open court in all the principal cities of Canada and concluded their formal hearings in Ottawa on May 3rd. These hearings were publicized in advance and any interested person was invited to make a submission in writing and might appear in person or be represented by counsel to support the views set out. Briefs to the number of 175 were filed by co-operative associations, boards of trade, trade associations, corporations, firms, individuals and public bodies. The figures from our twelfth annual report were quoted frequently and the entire report was incorporated by at least one trade association to show the stranglehold that co-operation was gaining on private business.

In addition to these public hearings, government officials were interviewed, a general questionnaire was sent out to a large number of co-operatives that did not submit briefs and the literature on the subject was reviewed. Accountants and economists were engaged on the technical staff.

Three of the commissioners visited Great Britain and

two visited the United States to learn of the co-operative movement in those countries especially with regard to income tax.

The commissioners concluded their work on September 25. There was a considerable delay in printing their report of 245 pages which was not available until December 11. Section VI is as follows:

Summary of Recommendations:

(In this section the word "customer" shall be deemed to include shippers and suppliers as well as purchasers where the context requires.)

(1) That section 4, paragraph (p), of the Income War Tax Act be repealed.

(2) That the Income War Tax Act and The Excess Profits Tax Act be amended to provide for the taxation of co-operative associations and organizations on the same basis as other persons in accordance with the recommendations which follow.

(3) That co-operative associations and organizations, joint stock companies, partnerships, and other bodies and persons shall be allowed to deduct, in computing taxable income, such amounts which are paid or credited to their customers, in proportion to the quantity, quality or value of goods acquired, marketed, or sold or services rendered; provided that:

(a) such amounts are paid in cash or its equivalent within six months after the annual meeting of the relevant fiscal period of the association, organization or company and within six months after the end of the relevant fiscal period of other businesses; or alternatively, that they are credited within the same period to each customer and exigible by him on giving such notice as may be deemed reasonable. (Appendix D.)

(b) the statute or statutes under which any such co-operative association or organization is incorporated or registered, or its by-laws, or a contract with its customers, hold forth the prospect that payments will be made in proportion to patronage.

(c) the company or other person holds forth the prospect to customers that payments will be made in proportion to patronage.

(d) payments in proportion to patronage shall be at the same rate to all customers with respect to the same type or class of commodities, goods or services, with allowance for differentiation in class, grade or quality where appropriate.

(4) That deductions from the gross proceeds of a customer's products be excluded from the income of the association, organization or other business, if applied against an obligation incurred by such customer to purchase shares, or to make other investment in the association; or if credited to the customer, and exigible by him on giving such notice as may be deemed reasonable. (Appendix D.)

(5) That amounts credited in proportion to patronage and deductions from the gross proceeds of sale of the customer's products, which were not deductible for tax purposes when credited

or deducted shall, nevertheless, be allowed as a deduction in the period during which they are paid to the customers.

(6) (a) That interest, on any form of investment in, or loan to, the association or other taxpayer having a fixed date of maturity, be allowed as a deduction, provided such interest is exigible annually by the claimant or creditor at the rate fixed at the time such investment or loan was made.

(b) That interest, on any form of investment or loan which is withdrawable on giving such notice as may be deemed reasonable (Appendix D), be allowed as a deduction if exigible by the claimant or creditor at a rate fixed in advance.

(7) That a newly formed association which obtains incorporation or registration under provincial co-operative legislation, or is incorporated as a co-operative under Dominion authority, for the purpose of producing and/or marketing natural products of its members or customers and/or of purchasing supplies, equipment, household necessities or services, for its members or customers and which is not owned or controlled, directly or indirectly, by an existing association, or a group of existing associations, shall, with the consent of the Minister, be exempt from income tax for its first three fiscal periods following the commencement of operations. An association claiming such relief should, nevertheless, be required to file annual returns in accordance with Part V of the Income War Tax Act in such form as may be determined by the Minister.

(8) That section 4, paragraph (y) of the Income War Tax Act be amended, if necessary, to include associations incorporated or registered under provincial co-operative legislation for providing co-operative housing service.

(9) That associations incorporated or registered under provincial co-operative legislation, or incorporated as a co-operative under Dominion authority, for the purpose of providing telephone services, distribution of electric power, or medical and hospital services, be exempt from income and excess profits taxes.

(10) That the Minister be given power to require all persons to make such annual returns of "patronage dividends" declared, or "deductions" made, as may be deemed desirable.

Recommendations 1 and 2 do away with the present provisions regarding the exemption of co-operatives and recommend that they be taxed as other companies. The Co-operative Union suggested that a co-operative be defined. It was expected that the commission would find a suitable definition. However, they propose that all businesses be treated alike and so avoid the extremely difficult problem of determining the degree of co-operation that would qualify for special tax privileges. Patronage bonuses, refunds of excess handling charges, and other similar amounts which are paid or credited to customers in proportion to the quantity, quality or value of goods acquired, or sold, or services rendered are to be deducted in computing

taxable income provided certain conditions are complied with. The co-operative or company or firm must hold forth the prospect to customers that payments will be made in proportion to patronage, such payments are to be made at the same rate to all customers and are to be paid in cash or its equivalent within six months of the annual meeting or credited within this period to each customer and withdrawable by him on giving reasonable notice. Application of patronage bonuses on the payment of shares or other investments is deemed to be payment equivalent to cash. Similarly deductions from the gross proceeds of a customer's products are to be excluded from the taxable income of the association if applied against an obligation to purchase shares or make some other investment or if credited to the customer and withdrawable by him on giving reasonable notice.

Patronage dividends and deductions from gross proceeds credited to customers and not withdrawable on notice, will be taxable income in the year earned but may be deducted from taxable income in the year in which they are paid out.

These recommendations will likely lead to some clarification of the equity side of the balance sheet. Hitherto balance sheets have been prepared showing deferred dividends and revolving funds and it has been impossible to determine whether such credits were liabilities or part of the capital and surplus. Amounts that are to be paid out at a fixed date or on demand will go into one category and amounts that may be paid out as, if, and when conditions warrant or the directors decide will go into another category.

With regard to interest the recommendations are that interest on any form of investment in or loan to the association having a fixed date of maturity on which the interest is payable annually at a rate fixed at the time the loan or investment was made be allowed as a deduction. Also, interest on any form of loan or investment withdrawable on notice be allowed provided interest at a rate fixed in advance is payable annually. This leaves as taxable, interest paid at varying rates or only if earned, and interest on investments with no maturity date and not redeemable after notice.

With regard to reasonable notice of withdrawal of patronage dividends at credit or loans to, or investments in the co-operative, one is referred to the practice in Britain as set out in Appendix D of the report. In Britain, the by-laws of the societies provide for reasonable notice of large withdrawals and limit the number of shares that may be redeemed to 10 per cent in any one year. In periods of crisis the directors may temporarily suspend redemption of shares.

The main report is in three parts. Part I deals with trading co-operatives and is in six sections. The first two sections deal with the development and organization of co-operative associations in Canada and present a brief review of the variation in types of organization and methods of financing. One subsection is significantly entitled "Variety and Uniformity".

Section III deals with the arguments relating to the taxation of co-operative associations. Representations were heard repeatedly that it was in the public interest to encourage co-operatives by granting them tax exemption. The commissioners are of the opinion that the granting of fiscal advantage is not usually a good method of giving special encouragement. Exemption granted to one class or segment of the community can hardly benefit the whole. The advantage accrues to all of the class to which it is granted including those who need it and those who do not and those who do not need it generally receive the benefit in greater measure than those who do.

It was also represented that there were no profits or income. The commissioners come to the conclusion that the associations and their members do receive income. It was represented that ordinary companies were at an unfair advantage because of competition from tax exempt co-operatives. The commissioners conclude that the chief competitive advantage that the co-operatives enjoy lies in their ability to set aside larger reserves than if they were taxed. However, they did find real fear of what might happen in the future because of these reserves and are of the opinion that it is desirable to remove the cause of these fears.

It was urged upon the commission that co-operative associations even though incorporated were not legal entities separate and apart from their members. The commission-

ers did not attempt to assess the advantages or disadvantages of incorporation but are of the opinion that corporate bodies are "persons" separate and distinct from the members associated with them.

In section IV are listed eleven proposed solutions that were made to the commission with brief comment on each.

Section V deals with conclusions and recommendations. As already stated the commissioners found that income was earned by the association and its members and that the association was a person distinct from its members. From these premises they proceed to determine which items should be taxed as income of the association, which items as income of the members and which items as income of both. Their reasons for coming to the conclusions are given and are well worth study.

Section VI is the summary of recommendations that I have read to you.

Credit Unions

After some 35 years experience in the Province of Quebec, credit unions spread to Antigonish, Nova Scotia, and from there to all provinces of Canada and, I believe, to every state in the union. At the end of 1944 there were in Canada 479,000 members of 2,007 credit unions with total assets of $92 million. Loans granted in 1944 amounted to $36 million and it is estimated that loans granted since inception have amounted to $215 million.

Provincial Credit Union Federations are established in all provinces and these are affiliated with the Credit Union National Association at Madison, Wisconsin. Recently steps were taken to organize a Canadian Credit Union Federation.

The income of credit unions is exempt from tax under section 4, paragraph (q). However, there were some tax difficulties because of the organization of federations and because of the fact that, due mainly to investment in victory loans, a large part of the income was coming from interest on investments. The deduction of personal income tax at the source at the rate of 7 per cent on share dividends was considered a troublesome nuisance because a large proportion of the members were not liable for tax and the amount deducted had to be claimed from and refunded by the government.

In Part II of the main report the commissioners recommend that the relevant section be amended to make it clear that the exemption applies to federations and that exempt organization must derive their revenue primarily from loans to members.

The commissioners also recommend that the 7 per cent deduction on dividends be discontinued. Happily, the first peacetime budget brought down by our Minister of Finance will end deduction at the source on all dividends so that item will not require special legislation.

Mutual Insurance Organizations

Part III of the report deals with mutual insurance organizations. The recommendations made are in line with those made for trading co-operatives with complete exemption recommended in the case of any insurer when more than half of the net premium income in Canada is derived from the insurance of farm property and other property not protected by municipal or other fire fighting services, or is derived wholly from the insurance of churches, schools, or other religious, educational and charitable institutions.

The main report consists of seventy-two pages. Follow- it are five appendices.

A. A statistical study of the relative growth of co-operative business in Canada.

B. Brief historical sketches of some of the larger and more important co-operatives in Canada.

C. A special study regarding the financing of selected groups of co-operatives in Quebec and Saskatchewan.

D. The taxation of co-operatives in Great Britain and the United States.

E. A history of the credit union movement in Canada.

The report has been well received by the Co-operative Union of Canada. On the other hand, the Income Tax Payers Association and others are outspoken against its implementation. Due to delay in printing, it cannot be considered by the present session of parliament. When it is considered, there may be considerable opposition to its findings.

The Co-operative Union of Canada

The Co-operative Union of Canada was formed in 1909. Mr. George Keen of Brantford has been its secretary continuously and Mr. W. C. Good has been president from 1921. This has been a national organization with a membership

consisting of individual co-operative societies. A magazine, The Canadian Co-operator, has been published regularly. The Union has done a very useful piece of work fostering the co-operative movement in Canada but it has never attained the strength that is possible. In 1943, it had a membership of 300 associations and an annual budget of about $5,000.

At a meeting held in Regina on June 28, 1943, two resolutions were passed regarding the future of co-operation in Canada.

1. That for the purpose of protecting, consolidating and developing the Co-operative Movement in Canada, and making it a more effective force not only in Canadian life but in the field of international relations, this meeting is of the opinion that a strong, representative, well financed and well staffed Canadian Federation of Co-operatives is much to be desired.
2. That in the opinion of this meeting the Co-operative Union of Canada, with the necessary changes in its structure and services, can and should be used to perform the functions of a national federation of co-operatives as set forth in the foregoing resolution.

The Regina delegates voted in favour of converting the union into a federation of provincial unions or sections, rather than a union of individual co-operatives.

A reorganizational committee was appointed. This committee, later enlarged to include representatives from all provinces, held twelve meetings from July 1943 to January 1945. The work of organizing provincial unions has proceeded until now such unions are organized in all provinces except Alberta and Quebec. It is expected that the Conseil Supérieur de la Coopération which has been functioning for some time in Quebec will act as the union for that province. It is hoped that organization in Alberta will soon be completed.

Early in 1945 Mr. A. B. MacDonald, Director of Extension, at St. Francis Xavier University, Antigonish, Nova Scotia, was engaged as national organizer and he has established an office in Ottawa.

The first annual congress of the reorganized union was held in Winnipeg, November 26th to 28th at which meeting organization was pretty well completed. Mr. W. C. Good, for twenty-four years president of the union, was made honorary president. Ralph Staples of Toronto was elected president. Mr. George Keen continues as general secretary

and editor of The Canadian Co-operator. In addition a vice-president and nine directors were elected.

An ambitious program of publicity, organization and education was outlined for 1946 by the national organizer and a budget of $40,000 was approved. Allocation of this assessment to the provinces was left with the national board.

The Co-operative Union of Canada will undertake the following activities: Publicity, education, planning, organization, co-ordination, supervision, legislation, legal protection and international affairs.

Membership in the provincial sections consists of local co-operative associations, provincial associations, and federations including wholesales and credit union federations.

The activities of the provincial unions will follow those of the national organization but will be more intensive for they are closer to the supporting co-operatives and will be in a better position to guide and direct their activities. The provincial unions will be autonomous provided their programs are kept in harmony with the policies of the national organization. They will have complete control over provincial finances but will be expected of course to meet the assessment of the national body.

An interesting development has been the formation of the Ontario Co-operative Union Rehabilitation and Personnel Training School. Short courses in co-operation have been held from time to time in Canada. A comprehensive course of twelve weeks' duration is now being offered. Classes are held in the University section of Toronto. One course of twelve students has been completed and the graduates have been placed in co-operative employment. The second course will be completed December 20th and already twenty students are registered for the third course. The syllabus includes a wide variety of subjects and is heavily weighted with bookkeeping.

British Columbia was one of the first provinces to enact co-operative legislation. Through lapse of time this act is felt to be outdated. The newly organized Co-operative Union of British Columbia is pressing for action. At the present time consideration is being given to the possibility of a study to be conducted jointly by provincial authorities and the Economics Division. The purpose of the study

would be to determine what revision in the Co-operative Act is advisable having regard to present practices in that province and also what form of supervision should be given by the provincial government. Various degrees of supervision are given by provincial governments, with that given in Quebec and Saskatchewan being outstanding.

Canadian Federation of Agriculture

As already stated, co-operation in Canada has been and still is predominantly agricultural. The Canadian Federation of Agriculture, an influential federation of farmers' organizations, includes in its membership many of the farmer producer co-operatives. Thus there is considerable duplication of membership in the two national bodies. However, the Federation of Agriculture, being a vocational group, does not include all those individuals or groups that are interested in co-operation. The Federation of Agriculture and the Co-operative Union will work closely together and the duplication of membership will be a source of strength.

Saskatchewan Department

The Co-operative Commonwealth Federation won a sweeping victory at the polls in the Province of Saskatchewan in June 1944. The new government, the first of its kind in Canada, established a Department of Co-operation and Co-operative Development. Mr. L. F. MacIntosh, who had been a field man for the Saskatchewan Wheat Pool, is the first minister and Mr. B. N. Arnason, for many years in charge of co-operation and markets in the Department of Agriculture, is the first deputy minister. A division of research has been established with Mr. A. H. Turner, formerly of the Economics Division, Dominion Department of Agriculture, its first director. It is also worthy of note that the new Department of Education has taken steps to see that the principles and philosophy of co-operation are taught in the schools and university in the province.

You will note that no reference has been made to provincial taxation. That is because the provinces surrendered their rights in income and corporation taxes to the Dominion government during the war. Now that the war is ended the Dominion has made certain proposals to the provinces with a view to continuing this arrangement for a period of years and these proposals are now the subject of discussion between the Dominion and the provinces.

Departmental Organization and Accounting in an Airplane Factory

By G. R. Patterson, B.A., B.Acc., C.A.
Quebec, P.Q.

FEW industries in Canada attained, in recent years, the degree of expansion and importance of the aircraft industry. Our very success in the past conflict depended upon the quality and rate of production of our airplanes. We were honoured in Canada, in being the training centre for thousands of pilots, and it is reasonable to believe that, now that their job is done, aviation may still have a paramount place in post-war reconstruction.

It is with this fact in mind that I have attempted to set down the following outline of departmental organization and accounting in a modern airplane factory. Needless to say, the scope precludes the possibility of showing all details, but a simple picture of the whole is sketched in broad outline hereunder.

Timekeeping, Payroll and Time Study

(a) Timekeeping. The employee's time is recorded on simple punch cards which are available to the employees at clocks located at various points in the main office building for the office employees, and in lanes at the main gate for the factory workers.

The card is punched in the morning and at night, and for the beginning and ending of any overtime. At the top of the card are spaces for the employee's name, department and serial number, and columns for his cost of living bonus, unemployment insurance, Red Cross deductions, war savings certificates, income tax deductions, and deductions for tools purchased from the company. The punch cards are extended and added by the timekeeping department, and a tabulated run is made weekly by the payroll department using tabulating machines, of the straight and overtime hours, total wages payable and all deductions therefrom. The timekeepers also make up a time ticket for each workman, which shows the account number to which each operation performed by the workman in that day is to be charged. Timekeepers are solely responsible for allocating

the account numbers and recording the workman's hours on each job and each part number.

(b) Tabulating and Payroll Department. Time tickets are tabulated weekly by account classification and total hours worked, the latter to agree with the tabulated run for hours from the punch cards. An analysis of office employees' time and indirect labour is made by the payroll department weekly, and a summary by departments is sent to the cost department together with the tabulated runs from the time tickets and punch cards.

The tabulating machine prints the pay envelopes and the tabulated run from the punch cards simultaneously, so that each employee gets a copy of the calculation of his wages on the face of his pay envelope which is filled by a payroll company with the required cash.

(c) The cost department sets up a parts card for each airplane part manufactured, showing labour, material and burden. Productive labour and labour hours are charged on these parts cards, and non-productive labour is charged to standing orders in the expense ledger. Burden is recovered on the basis of labour dollars rather than on a labour hour basis, at the rate determined monthly from the preceding month.

(d) Time Study. The time study department, having prepared an operation analysis sheet, clocking each operation, has arrived at the normal or standard time which should be required. An operation and rate sheet is set up for work on each contract, breaking the work down into elements, and also showing types of machines and tools used. The time shown on this report is compared with the normal on a third form, called a process sheet, which shows the relative efficiency of the workman's operation for each part number.

The time study department also handles the job of employee rating, setting the basis for promotion as the employee attains the efficiency to merit increased wages.

Purchasing, Stores and Material Control

(a) Purchase commitments are made only by the purchasing agent and the outside production manager. Purchase orders are issued from the request for purchase orders. The latter may be made by the:

Material superintendent

Factory manager
Production manager
Outside production manager
Executive engineer
Sales department

All requests for purchase orders are routed through the material superintendent's office to the purchasing agent or the outside production manager who makes the actual commitments and routes one copy of the purchase order to the following:

Traffic department
Inspection department
Accounting department
Stores

Traffic Department. This department acts as a source of information for other departments as to the movements of goods purchased, and obtains prompt or scheduled delivery of purchase orders. The main record is a deliveries chart, on which is entered for each part number:

The number of parts per plane—from the bill of material.

The number of planes on order.

The number of parts on order—from the purchase order.

The number of parts received — from the receiving reports.

The balance on order.

Purchase orders are filed under the different vendors and followed up to delivery. The delivery chart is used as a guide for purchasing by the material control department.

The deliveries charts are set up under two divisions; purchases for plane production, and requirements for sales orders for spare parts.

(b) Stores. Goods are received by this department prior to inspection, and receiving reports are made up and routed as follows:

Traffic department
Accounting department
Material control
Stores (records)
Production control
Outside production

The copies of the receiving reports forwarded to material

control and stores records form the basis for the entry of receipts thereon. Kardex records for the stores are kept by the stores department, in addition to the Kardexes for same kept by material control, and should show the same stock balance. A continuous audit of stock is done by the internal audit department. Stores include the following:

Raw material and purchased parts
Shop manufactured parts
Commercial utilities (instruments, etc.)
Sheet metal, tubing and extrusions
Finished parts

Issues from stores are on material requisitions or on work order production cards, described under planning and production control. The work order card is in quadruplicate and the white copy is punched for the quantity of stock withdrawn and sent with the material stock to the shop.

(c) Material Control. Requests for purchase orders are made up by material control from the bill of material and engineering drawings, and are routed as follows:

	Purchasing department	3 copies
(Stores kardex)	Material control	1 copy
	File copy	1 copy
		5 copies

Work Orders. Work orders are routed from the planning department in quadruplicate — buff, white, salmon and green—and are entered on the material control ledger which has a separate page for each class of material; the work orders are entered for quantity of parts required, by part number and plane release letter. Airplane releases are for a fixed number of planes and bear an alphabetical letter. When the part has been fabricated in the shop, the buff copy of the work order card comes back to material control and is again recorded to show completion of the part.

Kardex Records. This record shows the quantity of stock ordered with purchase order number, the quantity received with receiving report number, the price from the purchase invoice, the quantity issued and the quantity on hand, and the moving average price. Deletions are made from the record according to stock quantities shown on the work order cards.

Purchase Invoices. A separate division of material control deals with checking the purchase invoice against the request for purchase orders and against the purchase order. Account numbers are entered on each invoice showing the account to which the stock is to be charged. The invoice goes to the material control department so that the price can be entered on the kardex, and then goes to the accounting department for entry on the purchase register.

(d) Cost Department.

Materials. The cost department sets up the cost of each part issued, on its parts cards, from the buff copy of the work order card. Material is credited to production materials account in the factory ledger, and charged to work-in process account, through the material day book. The issues on the work order cards which are tabulated are put through the material day book in total. When a part is complete, the cost department is notified through receiving the green copy of the work order card. The corresponding parts card is then removed from the rack and routed to the parts cost day book. Through this record, work-in-process account is credited and finished parts stores debited, with the average unit cost of the material, labour and overhead. Overhead is charged at a standard rate established each month. The cost of the finished part is credited to finished parts, and charged to the following distribution accounts:

1. Airplane contract projects
2. Sales orders
3. Repair orders

Contracts. The transferring medium, recorded in the finished stores day book, for contract projects, is the position sheet, which records the fabrication of assemblies and sub-assemblies on the actual airplane.

Sales Orders: Parts sold on sales orders are credited to production materials account from the tabulated run of work order cards bearing sales order numbers, for material used. The corresponding charges are made to sales order cost cards in the sales order ledger. When a packing sheet for the sales order is received from the factory the sales order cost cards are credited and the cost of sales account for sales orders is charged through the medium of selling reports. The material day book is used to record the

charges to the sales order ledger and the finished parts day book is used to record the charge to the cost of sales account for sales orders.

Repair Orders: Withdrawals of material for repair orders are credited to production materials account from a tabulated run of the work order cards bearing A.R.O. or B.R.O. repair order members. The A.R.O. is for the manufacture of a main assembly and the B.R.O. is for the manufacture of a sub-assembly. A repair order includes disassembly, repair, and re-assembly of a fixed number of repair jobs of the same type and the order is closed off monthly after all charges for the month have been posted from the tabulated run of the work order cards. When the order is complete and ready to be charged to the customer, the repair order, which includes charges for material, labour and overhead, is credited through the finished parts day book and charged to a closed ledger. Repair orders-in-process which is the control account for repair orders is thus credited and repair finished orders, which is the control for the closed ledger, is debited, in the factory ledger. The closed ledger establishes the cost of the repair jobs to be charged to the customer.

Planning and Production Control

(a) Planning. Work order cards are prepared by the planning department, from engineering orders made by the engineering department from drawings for each part of the plane. The cards bear the following information:

1. Account numbers — manufacturing work-in-process sales order or repair order
2. Release letter A.B.C., etc.
3. Part name, description and number
4. Sequence of work to be done by department
5. Quantity and description of material to be drawn from stores (card is punched for same)
6. Number of part for next assembly to which part is assembled
7. Shop priority—whether part is main assembly, sub-assembly or sub-sub-assembly
8. Tooling required

(b) Sequence of Work Order Cards. Cards are in quadruplicate—white, buff, green, salmon—and are routed as shown herewith.

All (1. Engineering department
(2. Planning department

White	Buff	Salmon	Green
3. Material control	3. Material control	3. Material control	3. Material control
4. Production	4. Production control	4. Production control	4. Production control
5. Stores	5. Stores	5. Shop	5. Shop
	6. Material control	6. Stores	6. Stores
	7. Cost department	7. Shop	7. Shop
		8. Production control	8. Production control
		9. Planning	9. Cost department

1. All originate in engineering drawing
2. Planning department sets up duplicates
3. All go to material control for recording
4. All go to production control for recording on kardex
5. White goes to stores for filing, buff to stores as advice to stores department to have part ready, salmon to shop to be issued to workman, green for recording in department
6. Buff to material control to close kardex; salmon and green to stores to pick up material and recorded in kardex
7. Buff to cost department to open parts card; salmon and green to shop for fabrication of part
8. Salmon and green to production control to close kardex
9. Salmon to planning for filing; green to cost department to close parts card

(c) Production Control. Kardex records are kept of work order by releases. A staff of "stock chasers" is employed to keep parts moving from one department to the next in the shop, and to locate any trouble in routing.

(d) Scheduling. Production is scheduled by setting up parts numbers on charts according to shop priority. All parts for the total number of airplanes to be built are covered by setting them up by departments and issuing the chart covering the parts to the respective departments. Parts are then worked on according to their priority and position number. Manufacture comes under seven different positions. For position one (1) the shop priority sequence would be as follows:

1-F Final position
1-E Major assembly
1-D Minor assembly
1-C Sub-assembly
1-B Sub-sub-assembly
1-A Manufacture of detail parts

Shop priority for the manufacture of detail parts would therefore be "1-A", and in the case of position 2, it would

be "2-A." Shop priority for a sub-assembly would be "1-C" for position one (1), and so on.

Outside Production

Labour is purchased from outside companies on certain jobs, the material being supplied by the airplane company. The material is sent out on shipping instructions forms and credited to the material control kardex. When the job is allocated to a vendor it is recorded on the outside production kardex from the purchase order, and when it is returned complete by the vendor it is recorded on the kardex from the outside production routing card after passing inspection. The outside production routing card is then sent to finished parts stores so that the completed part may be recorded thereon.

Cost Records. A parts card is set up for each part worked, the credit going to production materials account through materials day book, for the material, and the parts card is also charged with the vendors service charge from the vendors invoice. When the part is complete, outside production account, which controls the parts card, is credited, and finished parts stores is debited, through the outside production day book.

General Accounting Department and Relation to Factory Ledger

(a) General Accounts.

Accounts Receivable. Sales invoices are charged on a sales invoice register and posted therefrom to accounts receivable ledger. Credits to accounts receivable ledger are posted from the cash receipts book.

Accounts Payable. Purchase invoices are entered in the factory voucher register and are posted to the accounts payable kardex ledger simultaneously by bookkeeping machine. The voucher register has columns for the various charges and a corresponding credit for the total accounts payable, which is credited to head office control in the factory ledger. This balances with the total credit to accounts payable in the general ledger, the offsetting charge being to factory ledger.

Cash Receipts and Disbursements. Cash books, through which receipts and cheques are entered and the bank reconciliation is maintained, are kept in the regular way.

(b) Factory Ledger. A factory journal and voucher

register are kept, all entries being charged to factory ledger production accounts, or the expense ledger which is controlled by the factory ledger. Tabulated runs of materials issued and time cards are provided from which charges are made to work-in-process account in the factory ledger, the subsidiary records being the parts cards. Indirect labour and factory expenses are charged to the expense account in the factory ledger, and recovered to production on the standard basis. Administration accounts are charged to expense accounts in the general ledger. Journal vouchers are systematically numbered and lettered, bearing the same number and an alphabetical letter for each month.

The above summary, which has touched only briefly on each topic, is usually broadened out by the executive, in a general procedure and organization memorandum book which is issued to all department heads in the plant. This facilitates harmony and co-operation. In the surroundings of the modern airplane factory, efficient work becomes the first consideration and this is accomplished only if there is first a well organized plan. Efficiency then becomes a pleasure.

Implications of the Profit and Loss Statement

By J. E. Smyth, C.A.
Toronto, Ontario

THERE is a sense in which the philosophy of figures suggests that accounting is an important branch of statistics. All figures, including those prepared by accountants, gain in certainty the more remote are they from their source. So it is that Professor Buchanan is able to speak of the "halo of precision" which a published statement of profit and loss acquires.[1] Significantly, the same characteristic of statistics emerges in relation to the attitude of senior executives towards financial statements placed before them by accountants.

By and large the human mind lacks the capacity to retain figures for long in their original form. Some minds prefer a simple transposition while others substitute billions

[1]N. S. Buchanan: The Economics of Corporate Enterprise, page 228 (Henry Holt & Co., New York, 1940.)

for millions. Consequently we never fail to be impressed by an official quotation displaying the air of authority. Many an abstract argument is brought to a premature finale by the clever debater who can rally statistics to his support. When figures have been quoted, the last word has nearly been said. It is an interesting study in statistics to note how the conclusive nature of figures breaks down upon investigation. Is there a tendency among those who follow the net profits situation to attribute too great a finality to the handiwork of accountants?

The statement of receipts and payments no doubt suffices under primitive circumstances. It is essentially an historical record which can be proved by reference to bank balances and cash boxes. For more complex undertakings it is held to be inadequate. The accountant's notion of "net profits" emerges and it is an abstract concept. It leaves room for differences in interpretation. Nevertheless, the statement of profit and loss has developed as an improved method of explaining an increase or decrease in proprietorship arising from regular business operations over a period of time. It is the writer's contention that the increasing use of the profit and loss statement as an instrument for internal control is not a legitimate extension of this purpose.

One of the requisites of any means for internal control is that the results be localized or dissected so that they can be attributed to component parts. In the case of the profit and loss statement, this localization generally may take three forms: (i) A shortening of the term over which profits are measured; (ii) an expression for profits by departments or by types of product sold; or (iii) a separate consideration of each item in the statement. It is here argued that any of these procedures will encroach upon the accuracy of the conclusions reached from the figures.

Length of Income Period

It has just been noted that operating results may be localized by reducing the length of the income period. The obvious reason for this attempt is that one may then analyze results before their causes become obsolete. Yet there are important reasons for believing that the figure for net profits will be more accurate the longer, within limits, is the period over which they are measured. The objection is admittedly a theoretical one somewhat weak-

ened by the fact that different criteria suggest different lengths of period for income measurement. But all at least suggest the increasingly arbitrary nature of the measurement as the period is shortened. This criticism is not intended to urge necessarily that income periods should be lengthened, but merely that the nature of the limitations involved should be more generally realized.

Depreciation is one case in point. It is an amortization of the serviceability of a fixed asset, which, it is recognized, is being consumed somehow in the course of operations. For the accountant's purposes, the original serviceability is represented by cost. The amortization is based on an estimate which may prove substantially wrong and in fact will prove inaccurate by some amount. It would not, of course, be sensible to argue that if the income period were to correspond to the length of the life of the fixed asset, the inaccuracies arising from depreciation estimates would disappear: assets of varying durability are customarily acquired at different times. Yet as the income period is lengthened, we are in a better position to gauge the accuracy of depreciation and to correct its discrepancies in the light of fuller developments without affecting profits for the longer period.

Perhaps less appreciated yet are the influences of the business cycle and seasonal factors. The difficulty here is in connection with fixed expenses. It must be generally true that the justification for fixed expenses as a charge against current revenue envisages a broader period of operation than the calendar year. To slice off fixed expenses in equal amounts for each year is to burden some years and to subsidize others. Only if the income period were to traverse the entire "business cycle" with its downswing, depression, upswing, and prosperity, could these inaccuracies of apportionment be levelled out.

The same problem appears again for a business with seasonal factors where an attempt is made to measure net income within some fraction of the calendar year. Is it reasonable to charge one-quarter of estimated "annual" fixed charges invariably against quarterly revenue when most of the sales are made in the autumn or in some other season? If this difficulty is to be overcome, a cost for overhead per unit of production is required, and this necessitates

a forecast of production, and in turn, of sales, over a much longer period. The preparation of quarterly statements is now further complicated by provision for income and excess profits taxes which make an accurate pro rata distribution of this item by quarters impossible without a correspondingly accurate forecast of the operating results for the entire year.

In addition to the limitations involved in the shortening process, the accountant may question the worth in any case of producing a continuous stream of net profits figures ticker-tape-like for executives. It is not clear that an executive is necessarily as mechanically rational as the theories which stress maximization of net profits would have us believe. Granted that there exist contracts by which executives' salaries are adjusted in accordance with operating results, and that there is the occasional executive who owns a substantial proportion of the company's stock, for the most part officials may never hope to share in any but a small fraction of the net profits which are pictured as the reward of their genius. There is the further consideration that the desire for pecuniary gain cannot be as important in firms already earning large profits as in those where the extra dollar means something really worthwhile in the way of improved living for those responsible. It does not seem likely that it can be profits alone which explain the whole drive behind industry; the excess profits tax appears not to have lessened the quality of managerial decisions as much as we should have been led to believe by the profits theory alone. The prestige and power of high office and the sporting excitement of expansionist programs must be assigned some significance in the pattern of the explanation of business decisions.

Departments or Products

The second type of localization for purposes of internal control is the dissection of profits by departments or types of product manufactured. Which is the most "profitable" division? Statements of profit and loss can be prepared which beg hasty conclusions.

A statement of profit and loss may show that a certain line of activity within a business is being pursued less profitably or even at a loss compared with other lines in the same firm. Yet there are many other considerations in

addition to these statistical results which must be taken into account before determining whether any particular type of activity should be abandoned. No satisfactory method has been devised for apportioning costs between joint products, for example. Broadly speaking, the problem of "joint products" is a relative one since there are many costs which are more or less common to all phases of operations within a business. We should appreciate the extent to which it is arbitrary to say that a certain portion is chargeable against one product while another specific fraction of costs relates to a different product. The sale of one product may help the sale of a second and a third product of the same company and salesmen's expenses and advertising might not be reduced materially if the one line which is made to appear "unprofitable" were discontinued; further, methods of research may develop new and more lucrative uses for this product; styles and tastes may ultimately swing in its favour: indeed there may even be contractual obligations in connection with its production which must be completed anyway. Even from the strict accounting viewpoint, the abandonment of the manufacture of one product may mean that the remaining products must then absorb all the expense of the salary of "key" men formerly allocated in part to the discontinued line; and that there may be a loss on the disposal of the manufacturing equipment which must then be prorated against the revenue of the more "profitable" products.[2]

Individual Items

The third type of localization mentioned for the purposes of internal control is the separate consideration of individual items in the operating statement. The profit and loss philosophy gives rise to energies directed towards (i) increasing revenues, and (ii) decreasing expenses. The interrelation between these two concepts is not immediately evident from the financial statement itself. As a result, there may be a tendency to concentrate attention on the one, taking the other as given. The mere form of the state-

[2]At present this is not allowable for income and excess tax purposes, whereas the depreciation on the former equipment would have been allowed. The various points mentioned in this paragraph have been set out in the answer suggested for question 3, Accounting I of the final examinations, December 1944, in THE CANADIAN CHARTERED ACCOUNTANT, June 1945, page 372.

ment may suggest that to reduce expenses is to increase net profits whereas the results themselves will not be as obvious and expenses "saved" may well take a part of the revenue with them in ways not immediately foreseen. It is not possible, for example, to foretell the ultimate effects of an increase or decrease in salaries or wages (or hours worked) by reference to the profit and loss statement. It is this writer's opinion that the statement will probably indicate the immediate short run results of the policy. But what will happen in the long run is another matter.

This then is the argument against the use of the profit and loss statement as an instrument for internal control: that the control will require localization, and that the various devices employed in dissecting the figures of the statement must necessarily introduce important arbitrary elements concealed in the too-conclusive appearance of the statistics themselves.

It is not submitted, however, that the profit and loss statement has no function to perform. Instead, it is suggested that it may be regarded as being in the nature of a window pane through which we may see a little of the procedures followed in economic governing by corporations. The modern corporation employs large numbers of persons, is often owned by large numbers of shareholders, and sells its product to large numbers of consumers. It can scarcely be contended that the nature of its activities is not of vital consequence to the community at large. We have no press gallery for our economic government. The role of financial statements as an alternative is a comparatively new concept. Its implications are such as to suggest a maximum rather than a minimum amount of useful information, in understandable form, in financial statements. Unfortunately at present many a published financial statement and report, as a window pane through which we may examine the workings of our economy, is made of frosted glass.

NATIONAL EMERGENCY TRANSITIONAL POWERS ACT

The National Emergency Transitional Powers bill, which was printed in our January issue as passed by the House of Commons, was slightly amended before being adopted. The amendments are:

In clause 4 the word "lawfully" was inserted, so that it now reads as follows:

4. Without prejudice to any other power conferred by this act, the Governor in Council may order that the orders and regulations lawfully made under the *War Measures Act* or pursuant to authority created under the said act in force immediately before the day this act comes into force shall, while this act is in force, continue in full force and effect subject to amendment or revocation under this act.

Clause 7 was added as follows:

7. In this act "war with Germany and Japan" means the war that commenced on the tenth day of September, one thousand nine hundred and thirty-nine against the German Reich and subsequently against Italy, Finland, Hungary, Rumania and Japan.

Existing regulations, which were based on the War Measures Act while it was in force, are brought under the new National Emergency Transitional Powers Act by order in council (P.C. 7414) dated December 28, 1945, reading as follows:

Whereas the National Emergency Transitional Powers Act, 1945, comes into force on the first day of January, 1946, and by its terms provides that on and after that day the war shall for the purposes of the War Measures Act be deemed no longer to exist;

And whereas under section 4 of the National Emergency Transitional Powers Act, 1945, the Governor in Council may, without prejudice to any other power conferred by that act, order that orders and regulations lawfully made under the War Measures Act or pursuant to authority created thereunder in force immediately before the day the National Emergency Transitional Powers Act, 1945, comes into force shall, while that act is in force, continue in full force and effect subject to amendment or revocation thereunder;

And whereas section 12 of the Interpretation Act provides that where an act is not to come into operation immediately on the passing thereof and confers power to make any order, that power may, unless the contrary intention appears, so far as may be necessary or expedient for the purpose of making the act effective at the date of the commencement thereof, be exercised at any time after the passing of the act, subject to this restriction, that any such order shall not come into operation until the act comes into operation;

And whereas it is necessary and expedient for the purpose of making the National Emergency Transitional Powers Act, 1945, effective at the date of the commencement thereof that those orders and regulations made under the War Measures Act or pursuant to authority created thereunder in force immediately before the first day of January, 1946, should be in full force and effect from such commencement and that there should be no cessation in the operation of such orders and regulations resulting from the War Measures Act (sections 3, 4 and 5 thereof) ceasing to operate;

Now, therefore, His Excellency the Governor General in Council, on the recommendation of the Minister of Justice, and under the powers conferred by the National Emergency Transitional Powers Act, 1945, is pleased to order and doth hereby order that all orders and regulations lawfully made under the War Measures Act or pursuant to authority created under the said act in force immediately before the day the National Emergency Transitional Powers Act, 1945, comes into force shall, while that act is in force, continue in full force and effect subject to amendment or revocation under that act.

Annual Reports of Canadian Corporations

By John R. Hopper, B.Com., C.A.
Montreal, P.Q.

ANNUAL reports of Canadian corporations to their shareholders are of a diverse nature both in the manner of narrative presentation and in the form or contents of the financial statements submitted. Some reports are of considerable length and include either one or a combination of items such as charts, tables, pictorial illustrations, etc., while other reports are confined merely to a summary of the year's operations from the president on behalf of the board of directors to the shareholders, together with the audited financial statements. The general purpose of the annual report is to convey certain pertinent information on the company's operations to the shareholders, management, employees and the public but the fundamental object of such reports is to give an account of the results to the shareholders. Although most Canadian reports are far less interesting than those of many of the large United States corporations, mainly due to the stereotyped method adopted, nevertheless definite progress has been made in recent years in expanding and improving the general appearance of reports in Canada.

The recently published annual reports of twenty-five large Canadian industrial companies have been reviewed and various observations have been outlined below. While it is recognized that the use of such a small sample may not be indicative of reports of Canadian corporations in general, it will serve to illustrate some of the numerous variations that do exist at the present time.

Of the twenty-five reports analyzed, ten consisted of a brief explanatory report and financial statements (balance sheet, income and surplus statements) and the auditors' certificate. Of the remaining reports, ten showed various long-term trends by means of graphic presentation or comparative data in tabular form, while pictures were included in eight cases; a statement of source and disposition of funds for the year appeared in only two instances. Apart from the financial statements, relative audit certificate and a list of directors and officers, nineteen reports were on the average of less than three pages, while the longest report

totalled twenty-seven pages and included twenty-one pictures, two coloured charts and one table. It is of interest to note that one annual report was published in both French and English.

Financial Statements

Before discussing the form of the financial statements, it is significant to note that 76% of the companies reported all figures to the exact cent and the largest corporation showing cents recorded assets of almost $200 million. Another interesting fact is that total assets of the twenty-five companies amounted to $1,730 million and income available for dividends aggregated $117 million of which $87 million were distributed to shareholders. The majority of the companies had their financial period coinciding with the calendar year but ten corporations had closing dates other than at 31st December. More than one-half of the companies published consolidated financial statements and of the eleven companies who did not consolidate their accounts, investigation showed that nine held investments in subsidiaries.

One of the major inconsistencies in the form of the financial statements, which is probably confusing to the layman (who often may be a shareholder in two or more of the companies), is the different terminology used to describe items of a similar nature. Furthermore, opinions vary regarding the proper location of certain figures, principally on the balance sheet, and this factor adds to the difficulties of those who are unfamiliar with accounting procedures.

Balance Sheet

At the present time most companies arrange the assets and liabilities on the balance sheet from current to fixed or long-term but the opposite was noticed in the case of four companies where the fixed investment was placed in the leading asset position and the capital stock section was the first item on the liability side. The use of comparative balance sheets—generally a two-year comparison—is becoming more common and eight of the companies employed this method of presentation in 1944. Generally speaking, there is a certain amount of uniformity in the nomenclature and position of many of the balance sheet items such as current and fixed assets, current and fixed liabilities and capital stock. The lack of consistency in the terminology and treatment of other items is more pronounced, however, and was

noticed particularly in the case of refundable taxes, deferred charges, various reserves and the surplus accounts.

In most corporations, the portion of taxes to be refunded after the war, in accordance with the Excess Profits Tax Act, was shown as a main heading on the balance sheet, usually between current assets and fixed assets; some companies, however, preferred to give it less importance by listing it as one of a group of items under "other assets", or "suspended assets", or "investments and other assets". The most popular wording for this asset was found to be "Refundable portion of excess profits tax" and this was used by fifteen of the companies examined although five of these companies qualified the term by adding "estimated". Other references to this item were: "Post-war excess profits tax credits (estimated)"; "post-war refund under the Excess Profits Tax Act"; "estimated future refunds of excess profits taxes"; "portion of taxes refundable after the war"; "portion of taxes on income, refundable under the Excess Profits Tax Act". Only four of the companies had no reference to the tax refund. On the liability side of the balance sheet, approximately 50% of the corporations failed to mention the refundable portion of taxes at all. Five companies referred to it under the caption "deferred surplus" and one as a "deferred credit"; in four statements it was classified as a separate item below surplus while in two cases it was mentioned that earned surplus included a certain amount for the refundable portion of excess profits tax.

One of the assets on the balance sheet, which is probably described in the greatest number of different ways and is usually the least important dollarwise, is that of deferred charges or prepaid expenses or some variation of either of these two terms. In most cases this item is shown under a separate heading between current and fixed assets and has been referred to as "prepaid expenses and deferred charges", "prepaid insurance and deferred charges", "prepaid expenses", "deferred charges", "deferred charges to operations", "deferred charges to future operations", "deferred charges to revenue", and numerous other titles. In two cases it appeared as part of the current or working capital and was called "unexpired insurance" or "insurance deposits and prepaid expenses"; in another case it formed one of a group of items (with refundable taxes) under the main heading "suspended assets" and was described as "un-

expired insurance premiums, taxes and deferred charges"; it was also included under "other assets" and classified as "charges to future operations: Insurance and other prepaid items". In the twenty-five reports examined, there were only two references to this asset that were exactly the same, namely "prepaid expenses".

The reserves for depreciation of fixed assets were recorded on the balance sheets of all companies in one of two different ways. In the published accounts of sixteen companies the reserves were deducted from the corresponding fixed assets to show the net depreciated book value of the investment; in one instance it was noted that the amount of the reserve for depreciation was not disclosed but it was mentioned that the assets were valued at "cost less depreciation". In nine of the companies the depreciation reserves were shown separately on the liability side of the balance sheet, usually immediately following current liabilities.

Although five companies made no reference to a reserve for bad debts, nineteen of the remaining balance sheets indicated that the accounts receivable were net after deducting a reserve; the actual amounts of the reserve were given in only four cases, however. A departure from the normal procedure was noticed in one company where a "reserve for contingencies and doubtful accounts" appeared under liabilities on the balance sheet.

In connection with inventories, more than one-half of the balance sheets reviewed contained some form of reference to a reserve against the possible future loss in inventory values. Most of these companies, however, did not show the amount of such reserve but merely revealed that an indefinite amount had been deducted as a reserve before arriving at the net inventory figure; in one case it was stated that stores and materials were "valued at cost less depreciation". Three of the companies disclosed as a liability the actual amount provided for possible inventory losses under the captions "reserve for future depreciation in inventory values", "reserve for possible future inventory price decline" and "reserve for future decline in value of inventories", while another company grouped this item under the term "reserve for future shrinkage of inventory values and other post-war contingencies".

Many variations were noticed in the terminology used to

describe a contingent or general reserve and a reference to this type of reserve appeared in approximately 50% of the published statements. Three of the companies showed a "reserve for contingencies" while a further three had provided a "general reserve". Other references to a reserve of this nature included "reserve for war contingencies", "reserve for post-war contingencies", "reserve for contingencies and exchange", "reserve for investments and contingencies", "reserve for contingencies and doubtful accounts" and "contingent, insurance and other reserves".

In addition to any of the reserves discussed previously (reserves for depreciation, bad debts, inventory losses and contingencies) and apart from reserves for insurance and employees' welfare, several of the companies had reserves on their books to cover other specific items. Some of these were "reserve for plant extensions and betterments", "reserve for depreciation of securities", "reserve for betterment and replacement", and "reserve for extraordinary repairs and renewals".

With respect to surplus accounts, more than 80% of the companies merely contained the usual brief designation "earned surplus". One corporation referred to this item as "profit and loss account" followed by earned surplus in brackets; another company had a main heading "surplus" and then two subdivisions, namely "earned surplus" and "refundable portion of excess profits taxes"; a third company showed "earned surplus" subdivided into the following three sections: "Appropriated surplus invested in the company's undertakings"; "deferred surplus—estimated future refunds of excess profits taxes"; and "unappropriated surplus". In connection with the treatment of the tax refund, it has been mentioned previously that five balance sheets contained a separate section called "deferred surplus". In addition to references to earned surplus, five companies had a "capital surplus" account on their balance sheets, three of which included brief explanations concerning the origin of such surpluses. Two other items were noticed which appeared to be of a capital nature but no reference was made to capital surplus; one was classified as "surplus on appraisals" immediately following the depreciation reserve, while the other was called "surplus resulting from reorganization of capital . . . etc." and preceded the earned surplus account.

Profit and Loss

Of the companies reviewed, fourteen contained either a "profit and loss account" or a "statement of profit and loss" together with a separate "statement of earned surplus". A variation in terminology was noticed for three companies which showed a "statement of income and expenditure" followed by an earned surplus analysis. The remaining corporations, with the exception of one, combined the two statements using various headings such as "statement of profit and loss and earned surplus", "statement of income and earned surplus", or merely "profit and loss account". There was one company which did not have a separate statement to record the operating results for the year since profits, depreciation charges and dividends were included on the balance sheet under the surplus section.

In the majority of cases, the profit and loss accounts were brief and gave only the minimum amount of information in order to comply with the various companies acts. Net sales values and cost figures were published in only six instances. It is interesting to note that six companies compared their profit and loss figures with those of the preceding year although eight corporations had included a two-year balance sheet comparison. In the case of one report, the profit and loss account showed the percentages of costs, expenses, taxes, and net profit to sales for the period under review.

In accordance with the Dominion Companies Act, certain information must be disclosed such as depreciation provided during the year, executive remuneration, directors' fees and legal fees, etc., and these were usually shown in one of two different ways. About 50% of the companies included these deductions as separate items in the body of the profit and loss statement while the remainder indicated most of the required figures by means of a footnote. Although the majority of the Dominion incorporated companies reported separate amounts for executive remuneration and legal fees, some corporations combined the two items in one total.

In connection with the depreciation charge, 80% of the companies showed the amount provided during the year as a deduction in the main section of the statement, despite the use of notes in some cases for the other statutory disclosures. Numerous variations in terminology were noticed: there were six references to "depreciation", four to "pro-

vision for depreciation" and two to "provision for depreciation and depletion", while the thirteen remaining companies each used a slightly different description. As a matter of interest, three corporations indicated that special depreciation had been provided during the period and used the following explanations: "Provision for depreciation (including special depreciation)"; "provision for ordinary and special depreciation"; and "provision for depreciation of plant and equipment—normal and accelerated".

Although there is a divergence of opinion as to which financial statement—balance sheet or profit and loss—should take precedence in the annual report, nineteen of the companies in the group analyzed elected to show the balance sheet before the profit and loss statement.

Conclusion

Without detracting from the usefulness of the statements submitted, it would appear that some worthwhile improvements could be made toward standardizing the accounting terminology used for describing items of a similar nature. In addition, although it is recognized that differences of opinion exist among accountants regarding the proper location of certain figures, principally on the balance sheet, it would be a definite advantage to the majority of shareholders if greater uniformity could be adopted in the statements presented.

Although the companies acts at the present time require that certain definite facts be disclosed, much additional information could be made available to the owners by means of an explanatory report—broadened in scope in most cases—to assist their understanding of the masses of figures submitted. Annual reports should be interesting and easy to read and should supply all the important facts. The use of charts, tables or some form of pictorial illustration would help to provide a clearer interpretation of the results for the period and the financial position at a given date; it would depend on the particular aspects of the business as to which method of presentation would be more readily adaptable. A statement could be inserted to show the source and disposition of funds for the year under review and schedules might be included to give a long-term comparison (say five or ten years) of operating results or balance sheet data. As mentioned previously, some progress has been made along these

lines, although only two companies of the twenty-five examined contained a statement of "source and disposition of funds" and only eight showed comparative balance sheets for a two year period.

Many Canadian corporations have made substantial progress in recent years, however, in their efforts to provide the shareholders, employees and public with a clearer understanding of the company's results and position but there is still room for more improvement before the layman obtains a complete grasp of the meaning of the published financial statements.

Letter to the Editor

FORM OF FINANCIAL STATEMENTS

Dear Sir:

I was much interested in the article on this subject in the December issue of THE CANADIAN CHARTERED ACCOUNTANT.

I would support very strongly any moves towards adoption of the system of presentation of accounts outlined. It is the logical and commonsense way of revealing the picture and I always use it myself in making analyses of companies. If necessary the term "balance sheet" should be discarded entirely from the companies acts, and buried forever. It is an anachronism—a throw-back to the earlier days of accounting and the "trial balance" mentality.

One criticism I have to make. The stating of ratio of current assets to current liabilities should not be encouraged. It is apt to create a false impression of the importance of such ratio, which, as most accountants know, is a meaningless year-end factor. It can be "window-dressed" easily and varies seasonally. Most of us have seen cases where companies pay off all their liabilities by 31st December cheques issued early the next month so that the liabilities show at nil, or very small, with astronomical effects on the ratio.

Yours faithfully,

A. Ian Fleming, C.A.,

Montreal, P.Q.

December 17, 1945.

Current Accounting Literature

By Frank S. Capon, C.A.
Montreal, P.Q.

PAUL T. NORTON presents a plea for some clear thinking on depreciation in the 1st December N.A.C.A. bulletin. He condemns straight line depreciation, which is never questioned by most of us, and also condemns tax incentive depreciation which, he claims, is a tax penalty to other taxpayers. While most accountants will not subscribe to all of the views put forth, there seems to be little argument with the fact that no one of our present recognized depreciation methods meets all circumstances, even within one company. It is unfortunate, but true, that we never know the proper depreciation to be charged to each period over the life of an asset until the asset is finally discarded or sold.

Taking Inventory

The same bulletin contains an excellent article by W. B. Atchison on the subject of physical inventories. An inventory system is set out in detail, with a sample staff organization, an outline of the duties of each member of the staff, sample forms and all other pertinent data.

Standard Costs

"Standards—Can They Be Swallowed Whole?" is the title of the third article in the above bulletin by W. I. McNeill, vice-president and controller of General Analine & Film. Like so many of the really outstanding articles on accounting, this one is very short, and the purpose is to

PUBLICATION ADDRESSES, AND PRICE PER COPY POSTPAID

Accountancy, Incorporated Accountants' Hall, Victoria Embankment, London, W.C. 2, England. 1 shilling.
Accountants' Magazine, 23 Rutland Square, Edinburgh, Scotland. 1s. 3d.
Accounting Review, School of Commerce, Northwestern University, Evanston, Ill., U.S.A. $1.
The Accountant, Moorgate Place, London E.C. 2, England. 1 shilling.
The Controller, 1 East 42nd St., New York, N.Y. 50 cents.
Cost and Management, 66 King St. East, Hamilton, Ont. 35 cents.
Harvard Business Review, Harvard University, Boston, Mass., U.S.A. $1.50.
Journal of Accountancy, 13 East 41st St., New York, N.Y. 35 cents.
The Internal Auditor, 39 Atlantic Street, Stamford, Conn., U.S.A. $1.
National Association of Cost Accountants, 385 Madison Ave., New York. 75 cents.
Taxes—The Tax Magazine. CCH Canadian Limited, 31 Willcocks St., Toronto, Ont. 35 cents.

consider the following three points: (1) Can standards be applied to, and digested by, all types of business? (2) Should actual costs be eliminated completely, for all types of business, when standards are introduced? (3) Are there some circumstances when both standards and actuals can live together happily with each serving its own particular function?

Accounting by Causes

While the claim to novelty of the system of accounting by causes put forward by J. B. Coffin, in an article in the 15th December N.A.C.A. bulletin, must be largely discounted, the article is nevertheless most illuminating as a treatise on good cost analysis and reporting. The scheme is not a radical departure from usual accounting practice, but rather a logical development, and provides for analyzing cost variances between those that are subject to cost reduction, those attributable to the level of production, those due to company policy, and so forth. A well drawn up set of specimen schedules is included as illustrations.

Profit Sharing by Employees

In the same bulletin, D. R. Thompson outlines the aims, principles, and operation of a profit-sharing plan in effect in the Snow-Nabstedt Gear Co. The plan is summarized clearly and concisely, and has been successful over a period of 20 years in building up a loyal and industrious group of employee-partners. In times of general labour unrest, all such types of employee remuneration schemes are worthy of study.

Fully Depreciated Assets

Accounting for assets which have been fully depreciated or amortized at special rates in wartime, but which are now found to be of full or partial postwar value, represents a special type of problem. Various phases of the problem are discussed in an article by Carman G. Blough in the December "Journal of Accountancy", and comments and suggestions are requested as the committee on accounting research of the American Institute is planning to issue a formal statement on the subject.

Industrial Accounting in Competitive Enterprise

Another authoritative article on the duties of industrial accountants, this time by M. A. Moore of General Motors, is included in the December "Journal of Accountancy".

Stressing the special duties falling on accountants under postwar competitive conditions, Mr. Moore covers accounting problems concerning costs, forward pricing, cost analysis, cost control, distribution, labour relations, and investment policies.

Auditing of Insurance Position

It has been said that insurance covers a multitude of possible losses or liabilities, and auditors may not always realize the extent to which they should satisfy themselves that insurable risks are adequately covered. A checklist of insurable risks and an audit program for insurance premiums and coverage is provided in an interesting article by S. Chan and J. S. Miller in the December "Journal of Accountancy".

Rehabilitating Internal Controls

Under the above title, D. P. Perry of the firm of Lybrand, Ross Bros. and Montgomery has written an excellent article on the need for postwar rejuvenation of internal control procedures, which is included in the December issue of "The Controller". Dealing separately with the various causes of present weakness in internal control and the necessary remedies, Mr. Perry demonstrates how necessary it is for the professional and industrial accountants to work together on the problem. Enforced wartime neglect of "non-productive" procedures, diversion of meagre staffs, suspension of normal development, and other factors have had their inevitable effects after six years of war, and Mr. Perry's check lists of points to be reviewed are therefore most timely.

Excess Profits Tax Termination

Some of the problems to be considered on the termination of excess profits tax are outlined in the official memorandum submitted to the British Treasury by the Institute of Chartered Accountants in England and Wales, and reprinted in the 24th November issue of "The Accountant".

Fantasy—With a Point

"Alice in Income Tax Land" is the title of an all too short fantasy by A. P. Hughes in the 8th December issue of "The Accountant". The Lewis Carrol brand of logic seems to be startlingly appropriate for a criticism of tax laws.

Obituaries

The Late Wilfred John Dawson

The Institute of Chartered Accountants of Saskatchewan announces with deep regret the sudden death of Wilfred John Dawson at Regina on 18th December 1945.

Born at Hull, Yorkshire, England, the late Mr. Dawson qualified for membership in the Institute of Chartered Accountants in England and Wales in 1902. Ten years later he came to Regina to practise his profession and joined in partnership with Mr. A. Perring Taylor. Since 1918 he has practised under the name of Dawson and Rosborough which name was continued after the death of Mr. J. W. Rosborough in 1938.

Mr. Dawson served on the Council of the Saskatchewan Institute during 1916 to 1917, 1926-27, 1935-36 and 1937 to 1938, and was elected a fellow in 1937. He was a prominent member of the United Church and was always interested in community affairs. Of a most kindly and genial disposition he will be greatly missed by his associates and a host of friends.

To those who are left to mourn his loss the Institute extends sincere sympathy.

Personals

Dunwoody, Nicholl, Saul & Smith, chartered accountants, Winnipeg, Manitoba, announce the following changes: The admission to partnership of W. W. Shepherd, C.A., who has been associated with the firm since 1936. The retirement from the partnership of Cecil W. Nicholl, C.A., who is now residing in British Columbia.

Paul Rising, C.A., announces the removal of his office from room 64, 553 Granville Street, to room 24, 615 West Hastings Street, Vancouver, British Columbia.

G. C. Rooke, F.C.A., and R. R. Thomas, F.C.A., practising under the firm name of Rooke, Thomas & Co., chartered accountants, 403 Leader-Post Building, Regina, Saskatchewan, announce that W. G. Smith, F.C.A., and H. S. Moffet, C.A., who have been associated with the firm for some years past, have been admitted to full partnership. The firm will continue with no change in name or address.

P. C. Metherell, C.A., who has recently been discharged from service with the Navy, announces the opening of an

office at 7 Hughson Street South, Hamilton, Ontario, for the practice of his profession.

Campbell, Glendinning & Co., chartered accountants, announce that they have admitted to the partnership G. Birks A. Hall, M.Com., C.A., and Charles H. Bray, C.A., both of whom have been connected with the firm for a number of years. As from January 1, 1946, the practice will be conducted under the firm name of Campbell, Glendinning, Dever & Camelford.

Robertson, Robinson, McCannell & Dick, chartered accountants, Toronto, announce the opening of an office for the practice of their profession in the Tyshler Building at No. 137 King Street West, Chatham, Ontario.

REFUNDABLE TAXES

For the purpose of determining the time for repayment of refundable portions of income and excess profits taxes, the date of cessation of hostilities is fixed at September 2, 1945, by order in council No. 7514 dated January 4, 1946, reading as follows:

Whereas in subsection (2) of section 93 of the Income War Tax Act it is provided that a portion of the income tax imposed and collected under the provisions of the Act in respect of the 1942 taxation period and certain subsequent taxation periods shall be repaid to the taxpayer at such times and in such instalments as may be prescribed by regulation made by the Governor in Council, but in the case of taxes paid upon income for the 1942 taxation period not later than the end of the second fiscal period of the Government of Canada commencing after a date to be fixed for the purposes of the Income War Tax Act and of The Excess Profits Tax Act, 1940, by the Governor in Council as the date of the cessation of hostilities between Canada and Germany, Italy and Japan;

And whereas by section 18 of The Excess Profits Tax Act, 1940, provision is made for refunding a certain portion of the taxes paid under that Act after the cessation of hostilities between Canada and Germany, Italy and Japan, and by subsection (3) of the said section 18 it is provided that the date of the cessation of hostilities shall be that date proclaimed by the Governor in Council that a state of war no longer exists, or such other date as he may determine for the purposes of refunds under the said Act.

And whereas active hostilities have now ceased between Canada and Germany, Italy and Japan;

Now, therefore, His Excellency the Governor General in Council, on the recommendation of the Minister of National Revenue is pleased to order that for the purposes of determining the date on or before which refunds of the refundable portions of the tax to be repaid under the Income War Tax Act and The Excess Profits Tax Act, 1940, shall be payable, the date of the cessation of hostilities between Canada and Germany, Italy and Japan shall be and is hereby fixed as the second day of September, 1945.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

In the Securities and Exchange Commission report on the McKesson and Robbins case there occurs (at p. 369) the passage "Whether the purpose of the engagement is to be more comprehensive than *merely securing certified financial statements* is usually determined by discussion . . .". And in the course of his judgment in International Laboratories Limited v. Dewar *et al.* Robson J.A. remarked: "There was discussion during the argument as to whether the audit was to be *merely the statutory audit* under sec. 123 of the Companies Act." [In each quotation the italics are our own.]

We wonder if some of our readers may not have been startled as we were, by the word "merely" as it appears in these two quotations and by the resultant implication that the auditor's statutory duty under our Companies Acts (or in any engagement calling for the verification of financial statements) is a light one not calling for any high degree of diligence, care and skill. It is clearly established by decisions of the Court of Appeal in England that the provisions with regard to the statutory audit of a limited liability company place upon the auditor the responsibility of deciding the nature and extent of the work which, in each particular engagement, he must do in order to form and express an opinion upon the statements. It is equally clear that if a professional auditor fails to exercise sound judgment in the selection of the work to be done, or much skill and diligence in the performance of that work he is guilty of negligence towards his client.

We do not believe that anyone who read carefully the judgment of either the trial court or appeal court in *Re* City Equitable Fire Insurance Co. Ltd. would use the word "merely" in reference to the annual audit of financial statements; for in that case the auditor did a very large amount of work with meticulous care and very considerable skill and yet, because in respect to the verification of one item he failed to exercise what the courts regarded as sound judgment he was held to have been negligent in the performance of his duty and would have been liable in dam-

ages to the company had he not been protected by an indemnity clause in the company's Articles of Association.

"I am convinced" (said the trial Judge Mr. Justice Romer) "that throughout the audits that he conducted he honestly and carefully discharged what he conceived to be the whole of his duty to the Company. If in certain matters he fell short of his real duty, it was because, in all good faith, he held a mistaken belief as to what that duty was". The Master of the Rolls, giving judgment in the Court of Appeal remarked: "Now it is right . . . . to say that the audit . . . . which was carried out by Mr. Lepine, the partner entrusted with it, was carried out with diligence and care . . . . Mr. Lepine had a task set before him which must be a difficult one at any time, but a task which, if he failed in it, would only have been recorded of him that he failed to do what would have been a very signal accomplishment if he had succeeded . . . .". And yet the auditor was held liable for dereliction of duty. If the standards of duty imposed by the English courts are applicable in this country, we think the use of the word "merely" in reference to the annual audit of corporation statements is unfortunate and misleading.

* * * * *

We noticed recently that the financial statements of a certain industrial company showed separate figures for "balance of profit and loss" and "earned surplus", the former presumably being the accumulation of earnings less dividends since a past date which was not specified, the latter the cumulation prior to that date. We failed to see anything in favour of this sort of segregation but we were not upset until we discovered that while the opening balance of profit and loss agreed with the closing balance of the preceding year, that of earned surplus showed a very substantial discrepancy on which no other facts or figures contained either in the accounting statements or the directors' report threw any light whatever. Surely, irrespective of statutory requirements, the management of a company is under a moral obligation to publish financial statements which are susceptible to interpretation.

PUZZLE

Where is the fallacy in the following algebraic demonstration that one equals two?

Suppose that a = b, then

$ab = a^2$

$\therefore ab - b^2 = a^2 - b^2$

$\therefore b(a-b) = (a+b)(a-b)$

$\therefore b = a + b$

$\therefore b = 2b$

$\therefore 1 = 2.$

SOLUTION TO LAST MONTH'S PUZZLE

If a clock takes eight seconds to strike eight it will take 12 4/7 seconds to strike twelve.

If a clock takes six seconds to strike six it will take 13 1/5 seconds to strike twelve.

PROBLEMS AND SOLUTIONS

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

INTERMEDIATE EXAMINATION, DECEMBER 1944

Accounting II, Question 5 (20 marks)

A. Co. Ltd. and B. Co. Ltd., which have been carrying on the same type of business for a number of years, decide to amalgamate as of 1st July 1944, and accordingly incorporate X Limited with an authorized share capital of $100,000 divided into 2,000 shares of $50 each. It is agreed that X Limited will acquire the assets at a purchase price to be determined by independent persons. In settlement of the purchase price X limited is to assume the liabilities of the vendor companies and to issue fully paid shares for the balance. The trial balances of the two companies on 30th June 1944, before any adjustments are made, are as follows:

	A. Co. Ltd.		B. Co. Ltd.	
	Dr.	Cr.	Dr.	Cr.
Accounts payable .... $		29,000		11,725
Accounts receivable	20,000		16,000	
Bank loan		10,000		
Buildings	15,000		10,000	
Cash	5,000		500	
Inventories	29,750		5,525	
Land	6,000		3,000	
Machinery	12,525		6,350	
Office furniture	1,425		750	
Prepaid insurance	300		125	

Share capital		35,600		20,000
Surplus		15,400		10,525
	$90,000	90,000	42,250	42,250

The figures submitted by the valuators are not in agreement in some respects with the above figures on the trial balances and the following adjustments are necessary:

A. Co. Ltd.
   Increase value of machinery to $15,025.
   Decrease value of inventory to $24,250.
   Decrease value of accounts receivable to $19,000.

B. Co. Ltd.
   Decrease value of buildings to $8,000.
   Increase value of inventories to $7,000.
   The valuators state it is impossible to arrive at a value for accounts receivable and they are to be taken over at $16,000 on the understanding that B. Co. Ltd. will make good any loss on collection.

In addition the vendor companies are to receive further shares equivalent to 10% of the net tangible assets taken over by X Limited.

Required:

Prepare opening journal entries and balance sheet of X Limited as it will appear immediately after the assets and liabilities have been taken over and the shares issued.

SOLUTION

X LIMITED

Journal Entries

1944		Dr.	Cr.
1st July	Accounts receivable	$20,000	
	Buildings	15,000	
	Cash	5,000	
	Inventories	24,250	
	Land	6,000	
	Machinery	15,025	
	Office Furniture	1,425	
	Prepaid insurance	300	
	Goodwill	4,700	
	To Reserve for doubtful accounts		$ 1,000
	Accounts payable		29,000
	Bank loan		10,000
	A. Co. Ltd.		51,700
	To record assets taken over from A. Co. Ltd. as valued by independent valuators.		
1st July	Accounts receivable	16,000	
	Buildings	8,000	
	Cash	500	
	Inventories	7,000	
	Land	3,000	
	Machinery	6,350	
	Office furniture	750	
	Prepaid insurance	125	
	Goodwill	3,000	
	To Accounts payable		11,725
	B. Co. Ltd.		33,000

	To record assets taken over from B. Co. Ltd. as valued by independent valuators. B. Co. Ltd. is to assume any losses on collection of accounts receivable.		
1st July	A. Co. Ltd.—1,034 shares of $50 each	51,700	
	B. Co. Ltd.— 660 shares of $50 each	33,000	
	To Share capital		84,700
	To record shares allotted and issued to A. Co. Ltd. and B. Co. Ltd. for assets turned over by them.		

X LIMITED

Balance Sheet — 1st July 1944

(after giving effect to acquisition of assets and assumption of liabilities of A. Co. Ltd. and B. Co. Ltd.)

ASSETS

Current Assets:			
Cash		$ 5,500	
Accounts receivable	$36,000		
Less—Reserve for doubtful accounts	1,000	35,000	
Inventories		31,250	
			$71,750
Fixed Assets:			
Land		$ 9,000	
Buildings		23,000	
Machinery		21,375	
Office furniture		2,175	
			55,550
Prepaid insurance			425
Goodwill			7,700
			$135,425

LIABILITIES AND CAPITAL

Current Liabilities:			
Bank loan		$10,000	
Accounts payable		40,725	
			$50,725
Capital Stock:			
Authorized—			
2,000 shares of $50 each	$100,000		
Issued—			
1,694 shares of $50 each			84,700
			$135,425

PROBLEM II

INTERMEDIATE EXAMINATION, DECEMBER 1944

Accounting II, Question 6 (15 marks)

Balance sheets of Y Limited as at 30th June 1943 and 1944 are shown hereunder:

	As at 30th June 1943	1944
Cash	$ 50,000	75,000
Accounts receivable	150,000	140,000
Inventories	275,000	300,000
Fixed assets	480,000	520,000

Patents	20,000	25,000
	$ 975,000	1,060,000
Accounts payable	$ 120,000	110,000
Reserve for taxes	60,000	70,000
Reserve for depreciation	120,000	135,000
Capital stock	500,000	500,000
Earned surplus	175,000	245,000
	$ 975,000	1,060,000

The net profit for the year ended 30th June 1944, after providing $20,000 for depreciation and $5,000 for amortization of patents, was $100,000. Dividends paid amounted to $30,000. During the year a machine with a gross book value of $10,000 and accumulated depreciation of $5,000 was sold for $4,000, the loss being charged to profit and loss.

Required:

From the foregoing information prepare a statement of source and disposition of funds.

SOLUTION

Y LIMITED

Statement of Source and Disposition of Funds
Year ended 30th June 1944

Source of funds:		
From operations—		
Net profit for the year		$100,000
Provisions and other charges to profit and loss which do not involve the current disbursement of funds:		
Provision for depreciation	$ 20,000	
Amortization of patents	5,000	
Loss on sale of machinery	1,000	26,000
Proceeds from sale of machinery		4,000
		$130,000
Disposition of funds:		
Expenditures on fixed assets	$ 50,000	
Expenditures on patents	10,000	
Dividends paid	30,000	90,000
Balance representing an increase in working capital		$ 40,000

	As at 30th June 1943	As at 30th June 1944	Increase or *Decrease*
Current Assets:			
Cash	$ 50,000	75,000	25,000
Accounts receivable	150,000	140,000	*10,000*
Inventories	275,000	300,000	25,000
	$475,000	515,000	40,000

Current Liabilities:			
Accounts payable	$120,000	110,000	*10,000*
Reserve for taxes	60,000	70,000	10,000
	$180,000	180,000	—
Working capital	$295,000	335,000	40,000

PROBLEM III

FINAL EXAMINATION, DECEMBER 1944

Accounting IV, Question 4 (25 marks)

From the following list of accounts of the Deeday Manufacturing Company Limited (at the end of its fifth year in business) prepare a balance sheet and statements of profit and loss and cost of goods manufactured for the year ended 31st December 1943:

	Dr.	Cr.
Land	$ 15,000	
Buildings—at cost	75,000	
Machinery—at cost	100,000	
Inventory—Raw material 1st January 1943	100,000	
Inventory—Finished goods 1st January 1943	50,000	
Sales—Manufactured goods		$ 620,000
Sales—Purchased products		200,000
Goods on consignment—at cost	1,500	
Imprest petty cash	100	
Cash in bank	6,000	
Freight in on raw materials	7,300	
Advertising	30,000	
Installation expense of manufactured product sold	15,000	
Purchases raw materials	225,000	
Purchases—purchased products	145,000	
Discount on sales	12,500	
Reserve for depreciation—buildings		12,000
Reserve for depreciation—machinery		40,000
Accounts receivable	75,000	
Notes receivable	65,000	
Notes receivable discounted		45,000
Accounts payable		200,000
Notes payable		50,000
Share capital (authorized and issued—1500 shares)		150,000
Call loan receivable	5,000	
Insurance	5,700	
Interest	2,500	
Dividend paid	15,000	
Mortgage payable		30,000
Factory wages	110,000	
Executive salaries	45,000	
Salesmen's commissions	72,000	
Office expenses	6,000	
Fuel power (no opening inventory of fuel)	80,000	
Factory supplies and expense	18,200	
Office salaries	20,000	
Equipment sold on 1st January 1943		3,500
Insurance on life of managing director	6,000	
Discount received		5,000

General sales expense	8,000	
Inventory purchased products 1st January 1943	15,000	
Deficit	24,700	
	$1,355,500	$1,355,500

Inventories 31st December 1943:	
Raw materials	$ 158,500
Finished goods	30,000
Purchased products	10,000
Fuel	2,000

The equipment sold was purchased on 1st January 1939 for $10,000. The premium paid in 1943 for insurance on the life of the managing director was $900, the cash surrender value at 1st January 1943 amounted to $3,400 and at 31st December 1943 to $4,000. Unrecorded wages payable as at 31st December 1943 amounted to $5,000 and unexpired fire insurance to $1,500. Ignore income taxes, but provide depreciation at the same rates as in former years. All fixed assets were acquired at the commencement of business.

SOLUTION

THE DEEDAY MANUFACTURING COMPANY LIMITED

Balance Sheet as at 31st December 1943

Assets

CURRENT ASSETS:				
Cash on hand and in bank			$ 6,100	
Call loan			5,000	
Accounts receivable			75,000	
Notes receivable		$ 65,000		
Less—Notes receivable discounted		45,000	20,000	
Inventories:				
Finished goods:				
On hand		$ 30,000		
On consignment		1,500		
		$ 31,500		
Purchased products		10,000		
Raw materials		158,500		
Supplies—fuel		2,000	202,000	$308,100
CASH SURRENDER VALUE OF LIFE INSURANCE POLICY				4,000
DEFERRED CHARGES:				
Unexpired insurance				1,500
CAPITAL ASSETS—at cost:				
Land			$ 15,000	
Buildings		$ 75,000		
Machinery		90,000		
		$165,000		
Less—				
Reserve for depreciation:				
Buildings	$ 15,000			
Machinery	45,000	60,000	105,000	120,000
Total assets				$433,600

DEFICIT:		
Balance 1st January 1943	$ 24,700	
Add—		
Adjustment relating to prior years:		
Reduction of life insurance to surrender value	1,700	
	$ 26,400	
Add—		
Dividend paid	15,000	
	$ 41,400	
Deduct—		
Profit for the year ended 31st December 1943 before taxes on income (Exhibit A)	40,000	1,400
		$435,000

LIABILITIES AND CAPITAL

CURRENT LIABILITIES:		
Accounts payable	$200,000	
Notes payable	50,000	
Wages payable	5,000	$255,000
MORTGAGE PAYABLE		30,000
SHARE CAPITAL:		
Authorized and issued—		
1,500 shares of $100 each		150,000
		$435,000

EXHIBIT A

THE DEEDAY MANUFACTURING COMPANY LIMITED

Statement of Profit and Loss

For the Year Ended 31st December 1943

	Manufactured Products	Purchased Products	Total
Sales	$620,000	$200,000	$820,000
Deduct—			
Cost of goods sold:			
Inventory 1st January 1943	$ 50,000	$ 15,000	$ 65,000
Cost of goods manufactured or purchased	401,200	145,000	546,200
Installation expense of manufactured product sold	15,000	—	15,000
	$466,200	$160,000	$626,200
Deduct—			
Inventory 31st December 1943	30,000	10,000	40,000
	$436,200	$150,000	$586,200
Gross profit	$183,800	$ 50,000	$233,800

Deduct—			
Selling and administrative expenses:			
Selling expenses—			
Salesmen's commissions	$ 72,000		
Advertising	30,000		
General sales expense	8,000	$110,000	
Administrative expenses—			
Executive salaries	$ 45,000		
Office salaries	20,000		
Office expenses	6,000		
Insurance on life of managing director	300	71,300	181,300
Net operating profit			$ 52,500
Deduct—			
Other expenses less income:			
Discounts on sales		$ 12,500	
Interest		2,500	
Loss on sale of equipment		2,500	
		$ 17,500	
Less—			
Discounts received		5,000	12,500
Profit before taxes on income carried to Deficit Account (Balance Sheet)			$ 40,000

EXHIBIT B

THE DEEDAY MANUFACTURING COMPANY LIMITED

Statement of Cost of Goods Manufactured

For the Year Ended 31st December 1943

Cost of raw materials used:			
Inventory—raw materials 1st January 1943 ...			$100,000
Purchases of raw materials		$225,000	
Freight in		7,300	232,300
			$332,300
Deduct—			
Inventory—raw materials—31st December 1943			158,500
			$173,800
Factory wages			115,000
Manufacturing expenses:			
Fuel—power		$ 78,000	
Factory supplies and expense		18,200	
Insurance		4,200	
Depreciation—			
Machinery	$ 9,000		
Buildings	3,000	12,000	112,400
Cost of goods manufactured carried to Statement of Profit and Loss (Exhibit (A)			$401,200